Transcribed Podcast - Vandenack Weaver S1 - E23 Mike Weaver -Year End Tax Planning

Speaker 1: (00:03)
Welcome to the Vandenack Weaver legal visionaries podcast brought to you by interactive legal. Here's your host, Mary Vandenack.

Speaker 2: (00:12)
Welcome to today's episode of Vandenack Weaver, legal visionaries, a weekly podcast discussing updated legal news, evolving methods of providing legal service and law practice issues. My name is Mary Vandenack founder and managing partner at Vandenack Weaver, LLC. I'll be your host. As we talk to experts from around the country about closely held business tax trust and estates, legal technology, law firm, leadership and wellbeing. Before we start today's episode, I want to thank our sponsor. Here's a message from interactive legal.

Speaker 3: (00:51)
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Speaker 2: (01:39)
On today's episode. I have Mike Weaver, Mike is one of my partners at Vandenack Weaver. Mike, I appreciate you being here today. No problem. Thanks for having me, Mary. So for several months, we've been dealing with legislative proposals that have the possibility of impacting year end planning. We're now in December, and we don't have any definitive legislation as we're recording this. One of the things I just want to talk about, because one of the really common phone calls I'm getting today is everybody thinks tax rates are gonna go up and it is true that we spend a lot of money to deal with a pandemic and some other issues and that's kind of the basis for that and the proposals have certainly proposed some significant tax increases but the fact is we haven't seen a real clear sign. We've had last minute legislation in the past.

Speaker 2: (02:27)
So I'm not saying it won't happen, right? I'm not have no magic ball and I'm not going to, you know, pretend that I do at all if only we did, but I, so what I'm kind of throwing out there before we go into the proposals is that there's some good basic tax principles that up fly generally, without regard to this year's legislation, because you can kneejerk to propose legislation and we've certainly seen that going on. We've certainly seen that going on our call volume, but the big generality is to really accelerate deductions and defer income. Right? And what the call we've been getting this year has been, should we do exactly the opposite, basically, assuming that rates are gonna go up and that's, we've seen that in the

business transaction department, I want to close the sale of my business before December 31 because the capital gains rate my go up. Anything ordinary income that I'm gonna have, that rate might go up as well. So I should recognize that income this year and the challenge with that is that we don't have definitive legislation yet. If that changes, we hope that anything might get passed before year end and you still have some time. So our focus has been on having people in a position to execute at the final hour if necessary. But Mike, do you really think we should be accelerating income into 2021? If we don't know, because they're gonna pay tax a year early, right?

Speaker 4: (03:52)
You know, the general, I think the general rule, which you described is still applicable. Now, there, are things in the legislation that the proposed legislation that may want you to change that analysis, but again, that's still proposed and a lot of the, and a lot of that legislation you got to look at when do those new tax rates come into effect. I mean, they're, the income levels are pretty high. Now there is an exception with the net investment income tax, which we can talk about a little bit, but generally speaking, I think just what you said, you want to defer your income, accelerate your expenses, but be ready to do something different in case something does happen in the last couple

Speaker 2: (04:30)
Weeks or so, be attentive to the proposals, but perhaps not overreact. For example, really at one point during this year, they were, there were the, the proposals included reducing the estate tax exemption from its current inflated amount of 11.7 million back to 5 million is inflated. So we had a lot of people wanting to do permanent irrevocable transactions, putting their 11.7 million exemptions in trust and at this point while we have a sense of a couple do years down the road doing it, just to anticipate the possibility of that exemption increasing is tying up a lot of money without necessarily knowing what's gonna happen. My policy has been, if this makes sense for you anyway, you should do it. But if it doesn't make sense and so I just want to talk a little more about sort of the standard protocol for year-end tax planning, which is, you know, defer income, accelerate deductions, but there's exceptions to that. So there would be, if I'm, for some reason in a super low rate year, let's assume no change in tax rates on the horizon, just for general discussion purposes but if I have low income this year for any reason, then it's maybe not the year I want to ex or to, I want to defer income. It might be a good year just because I'm in a lower rate and that's why we we're seeing the response to the proposals, it makes sense, but it's just that the proposals are still an unknown, right? Right.

Speaker 4: (05:56)
You know capital transactions are another good example. You may have a lot of capital loss this year. So maybe you do want to take some capital gains that that would be beneficial to you take them this year rather than next year. Because you have losses this year and you might not have those next year. Another thing that kind of comes to mind is with the, the cryptocurrencies, you know, a lot of people are starting to do trading and investing in those things and right now I don't think the wash sales rules are applicable to those.

Speaker 2: (06:27)
So you could actually do some wash sales and generate some losses with your cryptocurrencies and you know, take them this year. Now I, the proposed legislation takes that away makes wash applicable to

the cryptocurrencies ,but you know, that's just one, that's just one example of when the normal rule you might, it might not apply. But again, I think it's, it's so fact specific. I mean, we can have the general rule, which is, you know, defer your income and accelerate your expenses but like you said, if you're, if it makes sense for you to do the opposite this year, then that's what you want to do and so one of the reasons we like a team meeting of advisors, because that way you can kind of put your heads together with all the people that know what's going on and make some good decisions about that and sometimes calm the panic and we may still get some legislation and should be panicking, but we haven't gotten it yet as of today.

Speaker 2: (07:14)
We are checking just before we started recording and make sure there wasn't new news because we're sadly used to final hour legislation that all of a sudden it makes celebrating the holidays with our family and friends, somewhat challenging. So we celebrate Christmas in July, right? So let's talk about some of the strategies that exist. We'll talk a little bit about some of the proposed legislation that people should be thinking about. But one of my law long time, favorite strategies is retirement planning. So the one exception to that is the real estate investor. I spent a lot of years going, oh, you know, even though you're in real estate, we can talk about strategies. But the fact is there's so many other ways currently some of the proposed legislation is looking at that in real estate to create losses and things and keep income down.

Speaker 2: (07:59)
You know, if you, what you are primarily is doing in the real estate business, maybe it doesn't, but retirement plans in general, you get to take a current deduction for, from income, right? And so as a business owner, this is a strategy where if you don't have a retirement plan in place and you've had a really good year from an income perspective, going to still adopt a plan into the final hours and put funds in that plan and there's all different kinds of plan structures, which we're not gonna go into those different options, but just as a generality, sometimes people won't adopt a retirement plan because they have employees that I'll be really expensive to fund, but given the current availability of different strategies, it's actually just generally a good strategy to be using. Right. So let's talk a little bit about the other thing I want to talk about related to plans. Well, did you have any thoughts on that one, Mike?

Speaker 4: (08:54)
Well, I think, you know not in addition to, if you don't have a plan getting a plan set up, but even take a look at your current plan and see what you're able to do in your current plan, if you haven't, you know, if you're an employee and you haven't maxed out your, your contributions, you know, think about doing that. It you're an employer, a law firm.

Speaker 2: (09:13)
A professional firm and you can make a profit sharing distribution or a, you know, if you're doing a match contribution, make sure all that's getting done to help you not only yourself, but your employees, you know, get that income deferral. Another form of income is actually if you're a little older, so as a, a deduction, you can put money into the retirement plan and reduce your income and as you noted, even if you're an employee and don't have control over the plan, look at whether you're maximizing the deferrals that you're allowed to make into the plan. Same thing is true. If you have the ability to

contribute to a house savings account, which is one of my favorite strategies, because you can, instead of spending that down, let that accumulate to retirement and it's portable and basically never pay tax on it or the income if you use it for healthcare expenses.

Speaker 2: (10:03)
If you live to an older age, you're probably going to have healthcare expenses at some point in time that that money will come in really useful for we're fortunate to have a lot of charitably inclined clients and so we get asked about the ability to make charitable distributions with required minimum distributions. So when you hit a certain age, you're required to start taking money out of your qualified plan. So might be an IRA or you might still have a 401k and so you have to start taking those amounts and sometimes the theory, well, my income tax bracket will be lower when I'm older. So I'm gonna defer as long as possible. That's not always the case. So sometimes we have people who are taking required, minimum distributions, still in high income brackets or charitably inclined and there's a strategy that we hear a lot about the qualified charitable distribution. Can you give us some information on that?

Speaker 4: (11:00)
Sure. So if you are at the age where you're taking a required minimum distribution, what the code allows you to do is up to a hundred thousand dollars, you can designate a charity to receive that required minimum distribution, that RMD . So you designate the charity to get it and what that does is it prevents that minimum distribution from coming into your income. So you don't pay any income tax on it. And

Speaker 2: (11:30)
Just talk about the benefit of that for a minute. Okay. Because there's a lot of limits and there's some certain taxes that are based on adjusted gross income. Right?

Speaker 4: (11:39)
Right. So let's say you, weren't going to do this qualified charitable introduction, and you just said, okay, I'm gonna take my required minimum distribution. I get it and say, June and then in September, I decide I wanted to give it to charity. Well, it's not always a wash. I mean, if I get a hundred thousand dollars out of my plan as a required minimum distribution, and then I give a hundred thousand dollars to charity, my ability to take that charitable deduction depends on a lot of things, not the least of which is whatever you're adjusted, gross income, what type of charity you're giving it to. So there's, there's different things that can impact that. So it's not always a wash. The nice thing about this qualified charitable deduction, the, you know, the direct charitable contribution from basically your, your retirement plan is it never comes in income. So you don't have to worry about the wash. So it never comes in income. So you never pay tax on it and it's a direct contribution to the charity. So this there's no, there's no need for a wash. It's just never enters your income.

Speaker 2: (12:37)
So you don't, and you don't always get the wash anyway, because of the way the itemized deductions work. Right. So that's if you do a qualified charitable distribution, can I make that to any charity that I want to, or the, any limitations we set up a lot of private foundations for clients. So if I have a family foundation that we make contributions to, can that foundation be the recipient of my qualified

charitable distribution?

Speaker 4: (13:04)
It's for foundations it's possible if it's just a kind of a flow through. So if, if it's, I think if it's directed to go through the foundation to a qualified charity.

Speaker 2: (13:14)
So can I ask a question on that? So when does that mean? If I donated to my foundation, so foundations there's a calculation that basically is a 5% annual distribution. So in a typical year, I could put a hundred thousand in my foundation. I basically have to distribute 5%. That's very much over simplifying the explanation, but so, but I have a requirement to make a distribution. And so if I put this a hundred thousand in to the private foundation when you're saying it has to be a flow through, does that mean I have to give the whole a hundred thousand that year out of the foundation?

Speaker 4: (13:52)
My understanding is that it has to be the whole a hundred thousand going of the foundation into what is gonna be the qualified charity. Normally, if I just give it to a private foundation, that's not a qualified recipient of a qualified of this, a hundred thousand dollars deduction. It generally it's, it's 5 0 1 c 3 but importantly, private foundations are not and 5 0 1 c 3 it's mostly, if you think of a publicly support or to charity, that's, that's where you can send this type of, contribution but you know, donor advised funds is, are not available to receive these.

Speaker 2: (14:24)
I think that's really important to note because a lot of people use the donor advised funds very popular and really like, then they're really popular but the other thing worthy of note is the donor advised funds when people make contribution to those and a lot of people have great stories to tell about donor advised funds, and we certainly suggest them to clients, but there are a couple cases out there this year that have said, please realize that when you give money to a donor advised fund, even though you can advise it's not your money anymore, and you don't necessarily make the decision, right but as to these charitable distributions, that's not an option anyway and that's important so that you don't dump that a hundred thousand into the wrong place, correct? We are going to take a brief break from our episode for a word from one of our sponsors, Carson private at client wealth

Speaker 5: (15:11)
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Speaker 2: (16:11)
Okay. Continue our episode. Well, let's stay with the charitably inclined, but maybe move away from retirement plans just a little bit. So for 2021, as in 2020, we had some special rules related to charitable deductions, and those have been kind of for our philanthropic or some people just trying to level income, been very useful deductions. So typically your charitable deductions. And again, I'm not gonna go through the list, but know that when you make a charitable deduction, depending on who you're making it to, which type of institution or what type of charity affects how much you can deduct. So you can deduct less for certain types of gifts to private foundations. If I own a business and I have low basis stock it's, I own a hundred percent of the business, the private, foundation's not a good option, because I'm limited to basis in terms of the contribution, but generally how much I can give has some limits that are tied to adjusted gross income, which we've talked about before in 2021, there's a special rule. Can you speak to that?

Speaker 4: (17:16)
So for 2021 and, and the way it was in 2020, for cash contributions, there's basically an unlimited deduction now. So it's not subject to your, the amount of your, the amount, the deductibility of your, of your contribution is not subject to any AGI limits. If I give a hundred thousand dollars, I can take in cash and it, and if it's cash to a proper charity, then I can, I just get a hundred thousand dollars deduction. It's different. It doesn't become part of your itemized deductions is just, is you just get the, you just get the straight ride off, which is a pretty valuable deduction for this year and it, and it's going away. So that's why this is one of those that is pretty important to look at and

Speaker 2: (18:01)
useful for somebody who wants to do some donation and may have had a significant income event this year. So we've had a lot of income events with business sales. For example, we've had people who have had stock options that have been converted in a way that they're recognizing all of the income in 2021 because the business got sold and that's what made sense in the transaction. So you might be recognizing a lot more income than you're expecting and so we have clients with pledges who decided to accelerate the amount that they were giving into 2021 so that they could get a better donation, right. Or, yeah, and pay less paid a lower rate because if all of a sudden you're reporting all this income from this stock that you weren't expecting to you're in the highest tax bracket, maybe you weren't before that. Right? Exactly. So any other thoughts on that, Mike?

Speaker 4: (18:53)
Well, you know, this is one of those areas where not to get too much into the, into the proposed legislation, but you know, with the proposed legislation, particularly with regard to retirement plans, there are these new rules that may come into effect and that's, if you're over 10 million at the value of all your retirement plans is over 10 million, you are forced to take a special required minimum distribution equal to 50% of that excess until basically you're under 10 million. So if you're, if you have someone right now who is over that 10 million threshold and they're charitably inclined, this could be a good opportunity to basically take that 10 million, whatever the excess is over $10 million, you could donate that to a charity and you, because you have an unlimited charitable deduction, if you donate that cash, then that's a way to get your retirement account under $10 million and you get to deduction for it.

Speaker 2: (19:52)
Once upon a time, we didn't see that many retirement accounts at the $10 million mark, but you are now, but with the, you know, stock market in the last several years and the growth that we've seen, and historically the reason you didn't is because you do have limits on how much you can contribute every year. Right? And so most of the difference where we've seen all of a sudden had some of those retirement accounts of that size pop into view were clients who were maximizing their contributions, but also invested in a way that they're really benefiting from the growth of the market. Right.

Speaker 4: (20:23)
I think, I think the Roth I areas were also, there's been some complexity on some of the large, some pretty wealthy people with some pretty large balances in the Roth IRAs and that kind of got some people's attention. So that's why I think maybe, or had an impact on why these rules might be coming into play.

Speaker 2: (20:38)
So let's talk about the Roth IRA. So we talked about the qual, we were really talking about the qualified retirement accounts from the perspective of deductions that the Roth IRA has been a very popular tool the last many years. So can you just explain the Roth IRA in general briefly?

Speaker 4: (20:56)
Yeah. So the best way to the best way to explain it is probably to compare it to what, what everybody's familiar with. So like if you have a typical IRA and if attribute $6,000 max to it this year, I don't include that $6,000 or that 600, that $6,000 in income. So I basically don't include that in income. It sits in my IRA and it's a tax deferred account. So that $6,000 grows to whatever it grows to tax free. Then I'm taxed on it when I take it out. So I'm not taxed on it when I put it in, I'm taxed on it. When I take it out, the Roth is a little, just the opposite of that. When I make a contribution to a Roth, I don't get a deduction for it, but when I take it out, not I don't pay any tax on it. So I put it in, I don't get a deduction, but when I take it out, I don't pay any tax on it.

Speaker 2: (21:48)
What we've seen in terms of the popularity is projections of growth rates of those Roth's, which have been accurate because of the way the stock market has performed the last many years and people are finding that. Okay, great. You know, historically we wanted that deduction when we put the amounts in, which is still true, but it's one of those every year, you have to look at a lot of retirement plans, offer the option to elect part of your contributions to the Roth rather than to your traditional 401k type plan. Right? There's another strategy when you talk about the amount that somebody can do with an IRA. So there's a lot of people aren't qualified to make deductible IRA contributions. So if you're a participant in a 401k plan and at a certain income level, you may not be eligible for a deductible IRA contribution. So there's a strategy currently called the backdoor Roth IRA. That's also being targeted by the current tax proposals, right. Which haven't gone through yet, but can you explain that and what might happen to them, with those?

Speaker 4: (22:49)

So the Roth or the backdoor Roth again like with an IRA, there are, there are limits. If you have, if you reach certain income limits, then you can't make a, you can't make a contribution to a Roth. So the backdoor Roth is basically, I'm a little bit complicated transaction, but I'm gonna generalize a little bit. You're basically setting up a regular IRA and you're making a contribution to that because there are no in, there's a limit on how much you contribute to the, to the regular IRA, but there's, but it's not subject to your income. So you, I could put $6,000 into a regular IRA and then I basically do a conversion of that regular IRA into a Roth. So I backdoor my way into the Roth, but it allows me to make that contribution to a Roth IRA, even though I'm, I wouldn't otherwise be able to, with the income limits now $6,000 doesn't sound like much, but if you have you know, if you have, you may have, you know, depending on your plan, you may be able to con to like your 401k plan, if you have the ability to make after tax contributions, to your 401k, which some plans do, and some plans don't, you just have to check your plan, but you could make a lot larger to your after tax 401k account.

Speaker 4: (24:07)
Then you could roll that after tax account into a Roth IRA. So that's another way to do it, but that's, it's plan dependent and you got to look at two things that your plan does your plan have a Roth option or does your I'm sorry, does your plan have an after tax contribution option? Cause not all of them do and by after tax, I, I mean, if you've maxed out what you can contribute pretax or deferrals, you've maxed that out. Some plans allowed you to contribute more than that so if you're able to do that and your plan allows you to basically take an in service distribution, because again, not all of them do, but if those two, if you can check those two marks, you can, you can put a lot more into this backdoor plan.

Speaker 2: (24:48)
One of the rules on that backdoor plan is that your qualified funds all have to be in a qualified retirement plan versus an IRA. So one of the things you also have to look at, if you do have any IRA outside of a qualified plan, whether you can roll those in and that's because of the way the calculations of the contributions and the deductions occur, right? So it's kind of important to make sure that you're structured, right and not just jump into doing a backdoor rough. Right. Well, let's talk a little bit about everybody's least favorite cap on itemized deductions, which is the state and local tax deduction limitation, which basically said, you know, state and local taxes and Hey, we're based in Nebraska where we all know property taxes are high and sad to say we're ranked pretty highly an overall tax burden every year.

Speaker 2: (25:37)
So this tax affects us quite a bit and so that's currently limited to, you know, to 10,000 bucks. So state and local taxes is covering your property tax, personal property taxes, your real property taxes, your state income taxes, state sells taxes. Are, is there anything else that's included in that list that I've missed? Those are the highlights. So, and that's affected probably the most significant impact that I've seen in terms of it affects almost everybody. One of the things is that a lot of the states have been passing rules the well they're what we call salt workarounds. And this is important for anybody that owns interests in pass through entities. So pass through entities, several states. And actually, I think it's more than several at this point. I don't remember the members of this morning, but we, we got an IRS ruling that said we could do this salt workaround that it worked.

Speaker 2: (26:32)
Other salt workarounds got rejected by the IRS. This one has not. So what can happen is if you are a member in a pass through entity, so a partnership or an S S corporation that entity can elect to pay the taxes at the entity level, rather than you paying them at the personal level, take them as a deduction at the state level and that is one of your workarounds. So we're seeing that. So you might want to look if you do only pass through entity is just to see if that's an option. My recall and I don't remember for sure and I don't know all the different state laws, but is that election is made at the entity level. So if it's a multiple member entity, that has to be the various members agree on that, but we also have the build back better act the may or may not get passed. We just don't know, but is looking at the salt limitation, because that's been a fair point of contention. I think both parties have their issues with that limitation. So what's going on with that?

Speaker 4: (27:33)
Well, the proposal is to increase that limitation from the 10,000 up to $80,000. So it wouldn't go back to where the way it was, which was, you know, no limit on the deduction, but it would increase it up to 80,000. Now I, I guess the important thing about that is in at least the way the legislation has been proposed now, if they increase it to 80,000, that will be applicable for 2021. So if you do have some tax access that you can pay, you know, be ready to pay those, you know, if this does get passed near the end of the year, be ready to pay those because the salt limitation will go up from 10 to 80 for, for 2021,

Speaker 2: (28:14)
Which would be really helpful, very helpful. And a lot of people have been bunching deductions in one year or the other due to the various limitations or trying to pre you pay taxes, which is actually one of the strategies that got shot down is if you're paying taxes that aren't currently due to try and bunch those deductions, but you have the overall caps, you have to look at all the different taxes that are eligible to be paid. And some I think can be, but that's very much a state law issue that should be looked at and should be monitored as we go into year end. There's this other lovely little tax that got added on a few years. So I'm a big advocate for what really happens in the tax world is that we do a lot of tax shifting. And since I've been practicing, which has been a couple days now, uh, the number and types of taxes have increased dramatically. And I really wish for everyone that I know to really know how many different ways they're getting taxed. And so, and I don't remember in which act, and you might recall that, that we added this lovely new thing called the net. Do you want to talk about that tax?

Speaker 4: (29:18)
So the net, which is not really a net, it's a 3.8% tax. Well wait, so

Speaker 2: (29:23)
We, we I'm, we're talking in at acronyms and so you should probably say net investment income tax. Sorry about that. I that's, I started

Speaker 4: (29:31)
That's right. So it's the net investment income tax. Uh, and that, I don't remember what bill that came in, but was in

Speaker 2: (29:38)
2012. Okay. Sorry to put you on the spot on, but that's yeah, there's been a lot of them come in lately, but,

Speaker 4: (29:44)
But traditionally that has applied to what it says, that investment income. So you know, interest dividend, if, if it's passive activity, income, those types of things that are considered more investment income, but the proposal under the billback better act would be to make any trader business income, basically subject to that net investment income tax, once you hit certain thresholds. So, you know, that 3.8%, which used to be just, you know, a tax on your investment income can, is now gonna be greatly expanded and can hit a lot more of your income

Speaker 2: (30:18)
and that applies to trust income as well and so that's, we already have this, a trust income tax that applies at a very low level. And when we look at trust, we're saying, wow, the proposers of this legislation really hate trust and that's kind of sad to me because there's this thought process out there that trusts are only for the super-rich, which we established a lot of trust, you know, for you needs type trust for disabled and all types of trust that benefit people, protect assets, help make sure if you have a kid that has some challenges, even though they're in their mid-twenties, that you can kind of protect, make sure they have a backup plan if they haven't quite developed their own level of responsibility. So there's so many non-tax purposes of trust and we create them for so many different types of people that see this, you know, constant taxation on trust is a little bit concerning in my mind. So any other thoughts that you want to talk about on the net Mike?

Speaker 4: (31:17)
Well, I guess if I'm an S corporation I may pay a little more attention to the build back better and where that's going or if it gets past this year, because you know, a lot of S corporations will, will some will, you know, they structure, they, they, they structure their payments so that, you know, they take part of it is wages and part of it is a distribution. The wages are subject to I a and the distributions aren't if this new net passes and it's applicable to all trader business income, the distributions that you take would now be subject to the 3.8% tax. So it's, it's, it's basically, you know you're just paying an additional 3.8 on that income. So if you're an S corporation, this is one of those instances where if this gets passed, you might look at your income and for that you have coming in and say, I might want to get that income in this year rather than next year, because if I get it in this year, it won't be subject to the 3.8%. But next year it might.

Speaker 2: (32:22)
In long term, this affects the viability of the S corporation in terms of a lot of people use that and say, Hey, we're gonna do distributions instead of, you know, paying and it's still just the net, not social security, right? So you're not getting the full 15.3% hit. You're getting the 3.8, which is essentially the Medicare tax. But if I recall the nets actually a general fund tax I'm yeah, don't recall that for sure.

Speaker 4: (32:47)
And, and the net additional 3.8%, it's not, it's not gonna apply to income. That's already been subjected

to IICA. So if you've already paid your I on it, you're not gonna get hit with a 3.8% again, but it's, it's really that, that distribution part for an S corporation that we're talking about, the amount have distributed instead of that you take out of as wages,

Speaker 2: (33:05)
Right? And so any S corporation is gonna structure to their owners, their income. Some you're gonna pay compensation and the IRS says you have to at least pay some fair market value. So the strategy of only making distributions from an S corporation pretty well get shot down. So you want to do come with some kind of structure, and you're generally doing that structure to try and minimize the taxes, which is absolutely completely legal to minimize taxes. That's sure it is. I love that every year when I go to the NYU federal Institute of taxation and attend the ethical thing, it's completely an absolutely legal to structure your affairs in a way that minimize minimizes taxes that is far different from fraudulently avoiding taxes, or just ignoring the fact that income taxes exist right. Or any kind of taxes. That's right. So there's a trend that I've, we've just been seeing the last few weeks really come into play that I just want to talk about briefly.

Speaker 2: (34:00)
And that is the longstanding issue of when is somebody an independent contractor and when are they an employee? And if you have an employee, the employer has to pay the SOC has an employer, social security tax. So a lot of people miss the fact that they kind of hide that tax in terms of its overall hit. Because if you're employed, there's out of your paycheck comes 6.2% as the employer employee share. And 1.5, four, 5% as the Medicare share of and then the employer also pays identical amounts of taxes. In addition, the employer is paying both federal and state unemployment taxes. Well, as we all know, there's been a lot of funds paid out from an unemployment funds in the last couple years and so a lot of your state unemployment funds are a little short on cash. So the call I've gotten very recently and that's always been an issue at the federal level.

Speaker 2: (34:57)
So if you classify somebody as an independent con tractor and you're wrong, you as the employer are technically responsible for paying all the taxes that should have been paid, and those are trust fund taxes and you never want to be in violation of that rule. So the trend we're seeing right now is the states are coming after employers and telling the employers that they're misclassifying employees. Because if you have somebody working with you as an independent contractor, then they, you do not have to pay unemployment taxes on them and so the state's sort of funds are actually going after people and reclassifying employees as employees rather than independent contractors and my concern about that is that if the state is successfully, does that, then are we gonna have the IRS in there coming after the employees saying you should have done all this withholding of these trust fund taxes as well?

Speaker 2: (35:52)
Mm-hmm so I don’t know if you've seen that trend, Mike I've certainly had it come through my office few times, but any thoughts on strategies as to, you know, employers with that, because I've actually seen this where somebody's pretty legitimately an independent contractor and so we're gonna fight the states on the, the state on the one we're seeing, because I think the big picture on that is so significant for employers that if, you know, the it's just trying to get their percentage, which might not be that huge

but if all of a sudden I have this employer in a situation, the employer or independent contractor is long gone and they've been either reclassified and we're having to go back and figure out how to pay all those taxes because maybe the independent contractor didn't file a return or things like that. So what can employers do in evaluating that independent contractor issue?

Speaker 4: (36:42)
Yeah and it really is a, it really is a big issue , like you said, the state, the state's part of it is probably not that significant from the, from the employer standpoint, let's say, but the potential exposure to the federal level is huge because now you've got, you know, your seven point whatever percent that you didn't pay and those are, like you said, those are trust fund taxes and those follow you forever.

Speaker 2: (37:07)
They, and they're getting referred to criminal investigation at the federal level as well. So that's why, to the extent you get a call from the state on these issues,

Speaker 4: (37:16)
It's not a small matter. It may look small initially just, you know, the potential dollar exposure, but it's, but it's not and it really, it really comes down to, you know, control it's how much control do you have over that individual and what they're doing for you now, the IRS has a whole,

Speaker 2: (37:33)
So if I'm setting their hours telling them when they have to be in the office, things like that, that goes more and more towards employee, right? Once upon a time we had like a 10 factor test, but now it's become a facts and circumstances overall, very, and we had a very well, you know, it's been some pretty solid case law at the federal level when we're dealing with the IRS, but now we have all these, you know, 50 states and they're all taking their own on what an independent contractor looks like. So I just think it's a place for anybody who uses is looking at, can I treat this person as an independent contractor? And I'm not suggesting that you over favor employees, but be really clear and do some documentation agreements and make sure you're following the rules so that they're legitimately.

Speaker 4: (38:19)
If you have an agreement, make sure that that agreement is consistent with the way you're treating that person. So if you have, if you, if you're treating someone as an independent contractor, don't give them an agreement. That's entitled employment agreement. mm-hmm and if you have an independent contractor make sure there's language in there that says, Hey, we're treating you as an independent contractor these are the things that we're, that we're asking you to do, or maybe even requiring you to do, but limit those. So that it's clear that, you know, the amount of control that you're exercising over that individual is minimal.

Speaker 2: (38:50)
Also clarify that they're responsible for the payment of taxes and insurance which isn't really our topic today, but also very important. So any last thoughts, Mike today on things people should be thinking about as we're going into year end?

Speaker 4: (39:05)
You know, it's, a year end always, it's interesting. I think you and I were talking that the last five or so major pieces of tax legislation have at have happened after the 15th of December. So we don't know what's gonna happen, but you do have to be aware because you may have some year end tax stuff that you're just gonna want to get done.

Speaker 2: (39:25)
Thanks Mike. So you got to sit on ready here until year end and the other thing is I did want to re-mention I think you alluded it to earlier. We did do an earlier podcast on the estate tax effects of the current proposals and the good news on that is that the proposals are much less honorous at the end of the day than they were, but it's still worth paying attention to and good planning is always in order, but it did make our life a little easier at year end well, as we reach the end of our episode, I want to thank our sponsors, interactive legal and Carson, private client. That's all for now. Thanks for listening to today's episode and stay tuned for our weekly releases.

Speaker 6: (40:08)
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